GA1.13:PLRD-82-86

BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of The Army

COMPLETED
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Corps Of Engineers Procedures For Acquiring And Altering Leased Space Need Revision

The Corps of Engineers leases 13.5 million square feet of space for the Department of Defense at an annual rental of about $53.6 million. GAO found that the Corps:

--Usually did not advertise for space and seldom sought or obtained competition for lease awards.

--Generally did not prepare independent cost estimates when it contracted on a sole-source basis with lessors for alterations.

--Entered into some leases with provisions that were not in the Government's best interest.

GAO is recommending actions designed to improve the Corps' leasing procedures and practices.

GAO/PLRD-82-86
JULY 1, 1982

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

PROCUREMENT, LOGISTICS,
AND READINESS DIVISION

B-207075

The Honorable John O. Marsh, Jr.
The Secretary of the Army

Dear Mr. Secretary:

We have reviewed selected Corps of Engineers' practices and procedures for acquiring and altering leased space at the Corps' Baltimore, Maryland, and New York, New York, district offices. We made this review to determine whether the Corps was following sound leasing procedures and practices.

We found that the Corps needs to improve its procedures fo. acquiring and altering leased space. In summary, we found that the two district offices:

--Usually did not advertise for space and seldom sought or obtained competition for lease awards.

--Usually did not prepare independent cost estimates when they contracted on a sole-source basis with lessors for alterations.

--Did not comply fully with delegated authority to enter into multiyear recruiting office leases.

--Agreed to annual escalation of net rent (rental excluding the cost of maintenance, janitorial services, and utilities) on one lease.

--Paid rent and maintenance charges of about $646,000 for vacant space in one building during layout preparation and alteration.

--Did not make the required determination that the negotiated rent on three major leases was within the Economy Act limitation prior to signing the leases.

Detailed information on our findings is provided in the appendix.

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RECOMMENDATIONS

The Secretary of the Army should direct the Chief of Engineers to:

--Monitor the leasing program to ensure that space requirements are normally advertised and maximum competition is obtained through formal solicitations for offers. Whenever space requirements are not advertised, the lease file should contain written justification for not advertising.

--Revise the Corps' Real Estate Handbook to require independent detailed cost estimates based on final plans and specifications when the Corps contracts on a sole-source basis with lessors for alteration work anticipated to cost over a specified threshold amount.

--Issue instructions to district real estate officials not to enter into year-to-year leases which are contingent on the availability of appropriated funds for the payment of rental when leasing under multiyear authority delegated by GSA.

--Attempt to reach agreement with the lessor to eliminate the provision for escalation of net rent in the International Tower Building lease and issue instructions to district real estate officials not to accept such a lease escalation provision in future leases.

--Issue instructions requiring the Corps, whenever possible, to avoid paying rent for space before it is ready for occupancy. In those cases where rent is paid before occupancy, the Corps should attempt to negotiate a reduction in rent for reduced maintenance and other operating costs during vacancy periods.

--Issue instructions to contracting officers to determine whether negotiated rentals on applicable leases are within the Economy Act limit prior to signing the leases.

On May 3, 1982, we provided a copy of the draft of this report to the Departments of Defense and the Army for their oral comments. We met with officials of these agencies on May 14 to discuss the report, and they generally agreed with the report recommendations. However, the officials said that advertising for space, in some cases, is not feasible or productive. They agreed that whenever space requirements are not advertised, the lease file should contain written justification for not advertising.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee

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on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Secretary of Defense; the Director, Office of Management and Budget; and the Chairmen, House Committees on Appropriations, on Government Operations, and on Public Works and Transportation, and Senate Committees on Appropriations, on Governmental Affairs, and on Environment and Public Works.

Sincerely yours,

Donald J. Horan

Donald J. Horan
Director

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APPENDIX I

THE CORPS OF ENGINEERS NEEDS TO IMPROVE ITS PROCEDURES FOR ACQUIRING AND ALTERING LEASED SPACE

BACKGROUND

The Corps of Engineers is responsible for acquiring leased space in buildings for the Department of Defense (DOD) and the Departments of the Army, Air Force, and Navy. Its responsibility for acquiring leased space for the Navy, including the Marine Corps, is limited to recruiting facilities. The Naval Facilities Engineering Command is the principal leasing agent for other Navy facilities.

The Corps leases mostly under a delegation of authority from the General Services Administration (GSA), derived from section 210(h)(1) of the Federal Property and Administrative Services Act of 1949, as amended (40 U.S.C. 490 (h)(1)). It also leases space under its own authority derived from annual appropriation acts and 10 U.S.C. 2233, which authorizes the acquisition of leased space for Armed Forces Reserve facilities.

Upon DOD's request for an expansion of the delegated leasing authority for military recruiting offices, GSA, on September 10, 1979, reclassified space for military recruiting offices as special purpose space and delegated authority to the Secretary of Defense for a 5-year period ending September 10, 1984, to lease such space for firm terms of up to 5 years. The Secretary of Defense has delegated this authority to the Secretary of the Army who has redelegated it to the Chief of Engineers.

As of September 30, 1981, the Corps of Engineers was administering 7,982 DOD (including military services) leases involving about 13.5 million square feet of space at a total annual rental of about $53.6 million. According to information furnished by the Corps, as shown below, the amount of DOD space leased by the Corps has increased slightly in recent years but annual rentals have increased substantially.

As of fiscal year end	DOD leased space	Annual rental
	(millions of square feet)	(millions)
1975	11.9	$22.1
1976	12.2	26.0
1977	11.0	24.9
1978	10.2	26.2
1979	10.9	27.9
1980	13.2	48.3
1981	13.5	53.6

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The sizable increase for fiscal year 1980 was primarily due to the transfer of existing recruiting office leases from GSA to the Corps pursuant to GSA's delegation of leasing authority.

Most of the leases are for recruiting offices, reserve centers, and family housing. During fiscal year 1981, the Corps spent approximately $4 million on alterations of DOD-leased space.

The Corps' military leasing operations are carried out in 7 division offices and 17 district offices under policy and procedural direction from the Office of the Chief of Engineers, Washington, D.C.

OBJECTIVES, SCOPE, AND METHODOLOGY

We reviewed selected Corps of Engineers procedures and practices for acquiring and altering leased space. Our objectives were to determine whether the Corps was (1) obtaining maximum competition in lease acquisitions and negotiating with all offerors to secure the most advantageous proposal, (2) avoiding paying rent before leased space was ready for occupancy, and (3) adhering to sound procedures in contracting for alterations of leased space.

We made our review at the Corps of Engineers' Baltimore, Maryland, and New York, New York, district offices. According to the Corps, as of September 30, 1981, these two districts accounted for 2,386 DOD leases (30 percent of the Corps' DOD leases) with annual rentals totaling $25 million (47 percent of the total annual rental cost on the Corps' DOD leases).

We reviewed 22 of these leases with annual rentals totaling $2.2 million. We selected those leases whose initial term began after fiscal year 1974, concentrating mostly on leases with large annual rentals. We also reviewed 23 cases of lessor-performed alterations negotiated on a sole-source basis after fiscal year 1974 with a total cost of $252,587. We did not select the leases and lessor-performed alterations on a statistical sampling basis. However, we believe that we have reviewed enough significant leases and alteration projects awarded by the two district offices to indicate whether problems exist in the Corps' procedures for acquiring and altering leased space.

We reviewed lease files and related records, internal audit reports, the Corps of Engineers' Real Estate Handbook, Defense Acquisition Regulations, Federal Procurement Regulations, Federal Property Management Regulations, and provisions of the Federal Property and Administrative Services Act of 1949 (40 U.S.C. 471 et seq.) that pertain to the acquisition of leased space. We also had discussions with Corps real estate officials at the two district offices and at the Office of the Chief of Engineers. We made our review in accordance with our current "Standards for

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Audit of Governmental Organizations, Programs, Activities, and Functions."

LACK OF ADVERTISING AND COMPETITION IN ACQUIRING LEASED SPACE

Despite Corps policy favoring advertising and competition, the two district offices usually did not advertise for space and seldom sought or obtained competition for lease awards. Most lease awards were made on the basis of a single offer.

In reviewing the 22 new lease awards (16 at the Baltimore district office and 6 at the New York district office) we found that the Corps did not advertise its space requirement and solicited and obtained multiple offers for only 4 awards. Instead of advertising and soliciting offers from all potential lessors, the district offices, in some cases, merely performed a market survey of available space, and then negotiated a lease for the location selected by the requesting command.

The market survey usually was not documented in the lease file. In other cases, apparently no market survey was performed; the requesting command identified a specific location to the Corps and the Corps then negotiated a lease for that space. At the Baltimore district office, the standard form 1036, Statement and Certificate of Award, in the lease files usually contained the following pro-forma statement over the stamped signature of the Chief of the district's Real Estate Division:

> "A thorough survey and canvass of available facilities at _____ (specified location) and vicinity have been made and the only facilities which would satisfactorily fulfill the requirements of the using agency are those described in the captioned lease. Therefore, it is the opinion of the undersigned that advertising would be impracticable and not in the best interest of the Government."

Similarly, in November and December 1980, the Corps' North Atlantic Division resident auditor made an audit of a selected sample of recruiting office leases at the Baltimore district office. He found that formal advertising was performed for only 3 percent of the leases and that in most of the files, the standard form 1036 was blank except for the contract number, the date, and the stamped signature of the Chief of the district's Real Estate Division.

Most Corps leases were awarded under leasing authority delegated to DOD by GSA and were, therefore, implicitly subject to GSA's leasing procedures. GSA's policy for leasing requires that competition be obtained to the maximum extent practical among suitable available locations meeting minimum Government requirements. To ensure that competing offers are proposed, compared,

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and evaluated on the basis of uniform criteria, GSA prepares and issues a formal solicitation for offers specifying its space requirements and proposed lease terms and conditions. This solicitation is the basis for the entire process of negotiation. Offers received in response to the solicitation must be evaluated in strict accordance with its provisions.

The Corps of Engineers' Real Estate Handbook states that:

--As a rule, procurement of space will be by formal advertising.

--Leasing without advertising is permissible where only one location will serve the Government's purpose.

--In every instance, efforts should be made to seek competition.

--For each lease, a statement concerning competition in the solicitation for space is required on the standard form 1036.

--Where specific space is needed and competition is therefore not involved, the facts and circumstances must be fully explained and be made a part of the lease file for future reference.

Corps officials told us that recruiting criteria often require recruiting office space to be obtained within a narrowly delineated area which contains only one suitable location. They also said that advertising and soliciting offers would not have been productive in localities where the type of space required was scarce. The officials said that advertising and soliciting offers also would have been too time consuming if the space was urgently needed or if the desired location was in demand. They conceded, however, that market surveys were only likely to uncover currently available locations while advertising might result in identifying space that may become available in the near future.

Also, Corps officials told us that the leasing program for recruiting offices is highly results oriented, that is, the need to fill space requests quickly outweighs other considerations. We found that the Corps is more responsive than GSA to DOD's space needs. It filled space requests for recruiting offices much faster than GSA. However, this timeliness was achieved by not using the more sound leasing procedures for encouraging maximum competition required by GSA.

GSA survey team's findings

In August 1980 a GSA survey team visited the Baltimore district office to examine its implementation of GSA's delegated leasing authority to acquire space for recruiting offices. The team found that Corps acquisition practices were inconsistent with GSA's policy of obtaining maximum competition to the greatest extent practicable. In essence, available recruiting locations were identified to the

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district office by local recruiters based on recruiting criteria. The GSA survey team examined files of recently completed leasing transactions and found that:

--All of the leases examined were sole-source acquisitions.

--The lease documentation could not meet GSA's standards. The same standard findings and determination statement justifying sole-source lease acquisitions was made in each case, instead of a case-by-case justification used by GSA.

--The lease files examined contained no data showing that market surveys were performed to identify alternative locations and prices.

INDEPENDENT ESTIMATES OF LESSOR-PERFORMED ALTERATIONS NOT PREPARED

We found that the Corps usually did not prepare independent cost estimates when it contracted on a sole-source basis with lessors for alteration work. Instead, the Corps usually relied on "fair and reasonable" reviews. Under this procedure, a member of the district's Engineering Division would review the lessor's price proposal and determine whether it was fair and reasonable. Sometimes there was no documentation in the file showing that any estimate or fair and reasonable review was done. In our opinion, the lack of independent estimates limited Corps negotiators' ability to question lessors' proposals and evaluate the reasonableness of prices. Proposals submitted by a sole-source contractor require closer scrutiny than competitive bids.

The Corps of Engineers contracts for alterations in leased buildings on a sole-source basis with lessors or on a competitive basis with third party contractors. The Corps prefers to have lessors, rather than third party contractors, do the alterations in leased buildings because of insurance, taxes, maintenance, restoration, and other considerations. If the lessor is unwilling to contract for the alterations or if agreement cannot be reached as to price, the Corps usually solicits bids under the competitive procurement process and contracts with a third party to accomplish the alterations.

At the New York district office, we reviewed 11 cases of alterations negotiated on a sole-source basis with lessors. These alterations varied in amounts from $33,225 to $399. Independent estimates were prepared for only two of the cases (one for $29,817 and the other for $5,300), fair and reasonable reviews were done on eight cases, and there was no record of an independent estimate or fair and reasonable review for the remaining case. Two of the fair and reasonable determinations were based on Corps estimates that were apparently adjusted to agree exactly with the lessors' price

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proposal. Also, for four of the fair and reasonable determinations, the files contained no backup computations to support the determinations. For one of the eight, we noted that the fair and reasonable determination was made on the lessor's cost submission for completed work in the amount of $13,276.34, rather than on a proposal for work to be done.

At the Baltimore district office, we reviewed 12 cases of alterations negotiated on a sole-source basis with lessors. These alterations ranged from $34,500 to $4,147. There was no record of either an independent estimate or a fair and reasonable review for any of the 12 cases in the files, although district officials said that fair and reasonable determinations were made.

As a result of our discussion with Corps officials in Washington, D.C., the Director of Real Estate, Office of the Chief of Engineers, on September 17, 1981, issued instructions to district engineers that as of October 1, 1981, an independent cost estimate must be prepared and included in the lease file where the lessor is to accomplish initial alterations or items of upgrade as part of the lease agreement. This instruction applies only to recruiting office leases. We believe it should be applied to all Corps leases. Effective implementation of such an instruction should improve procedures for evaluating lessors' proposals for alteration work.

Requirements for independent estimates

Various Government regulations require independent estimates of the cost of alterations to aid in evaluating lessors' proposals. The Federal Procurement Regulations, FPR 1-18.108, require that an independent Government cost estimate be prepared for each proposed construction contract (including alteration contracts) of $10,000 or more. The estimate is to be as detailed as the contractor's bid.

GSA's leasing procedures require an independent estimate for all alterations in leased space exceeding $500 as a basis for determining reasonableness of cost. Such estimates are to be requested in writing at the same time that the lessor is requested to submit a proposal for the alteration work. These estimates are to be prepared without knowledge of any element of the lessor's price offer.

The Defense Acquisition Regulation, with certain exceptions, requires an independent Government estimate for each proposed construction contract anticipated to cost $25,000 or more. However, the Defense Acquisition Regulation, like the Federal Procurement Regulation cited above, does not apply specifically to alterations in leased space. Furthermore, the Corps' Real Estate Handbook does not require independent estimates for alteration work in leased space even though such alterations are usually negotiated on a sole-source basis with lessors.

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LEASES FOR MILITARY RECRUITING OFFICES DO NOT REFLECT 5-YEAR LEASING AUTHORITY

As previously mentioned, upon DOD's request for an expansion of the delegated leasing authority for military recruiting offices, GSA, on September 10, 1979, reclassified space for military recruiting offices as special purpose space and delegated authority to the Secretary of Defense for a 5-year period, ending September 10, 1984, to lease such space for firm terms of up to 5 years. Prior to that time, DOD was authorized to enter into 1-year leases. An official of the Office of the Chief of Engineers told us that DOD had requested the 5-year leasing authority to provide greater stability to the recruiting program and because of the potential for negotiating a lower annual rental on multiyear leases.

We found, however, that the Baltimore and New York district offices were writing recruiting office leases for (1) initial terms of 1 year or less and (2) initial terms of more than 1 year, with automatic renewal annually until a specified date within the 5-year term limit, "provided that adequate appropriations are available from year to year for the payment of rental."

In the Baltimore district office, recruiting office leases were written for an initial term of 1-year or more with automatic renewal annually until a specified date, provided that adequate appropriations are available. In the New York district office, recruiting office leases were usually written for an initial term of less than a year, with the initial term running from the effective date of the lease through fiscal yearend and with automatic renewal annually until a specified date, provided that adequate appropriations are available.

Such year-to-year leases may not be acceptable to some lessors willing to lease only for periods longer than 1 year because the leases appear to allow the Government to refuse to renew a lease at the end of a given year with no further liability to the lessor. It is usually in the best interest of the Government to enter into multiyear leases because they may attract more potential lessors and afford a lower annual rental than leases for 1 year or less.

District officials told us that they made lease renewals contingent upon the availability of appropriations because they could not visualize how the Corps could write multiyear firm-term leases when rental payments are provided by annual authorization and appropriation acts. On the other hand, GSA enters into multiyear leases and the rental payments are appropriated annually.

We discussed this matter with officials at the Office of the Chief of Engineers. They agreed with us that the Baltimore and New York district offices were not properly exercising the delegated authority to lease recruiting offices for up to 5 years. The officials believe that when leasing under a delegation of authority from GSA (which has authority under the Federal Property and

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Administrative Services Act of 1949, as amended, to lease for firm terms not to exceed 20 years), the Corps derives its authority from the 1949 act, rather than from annual appropriation acts. Use of year-to-year leases contingent upon the availability of appropriations renders the delegated multiyear leasing authority meaningless because some lessors would consider a lease with such a provision as a short-term lease. The officials said they would look into the matter and see that corrective action is taken.

RENTAL ESCALATION PROVISONS COULD SUBSTANTIALLY INCREASE LEASE COSTS

The Corps agreed to annual escalation of net rent (rental excluding the cost of maintenance, janitorial services, and utilities) when it leased the International Tower Building, Baltimore-Washington Airport, Maryland, for the National Security Agency (NSA) in June 1980. The lease's rental adjustments clause provides that, subject to the limitations of the Economy Act of 1932, the net rent will be increased each lease year, beginning with the second lease year, in accordance with the appraised fair market rental value of the leased premises. However, as discussed on page 10, the Corps' contracting officer did not make the required determination of the Economy Act rental limit for this lease at the time of lease award and, therefore, was not in a position to know the limit on escalation of net rent when he signed the lease.

The Economy Act will limit the escalation of net rent on applicable leases. However, the Congress is currently considering legislation, which, among other things, would repeal the Economy Act. If the Economy Act is repealed, there would be no limitation on escalation of net rent.

Escalation of net rent could have a sizable impact on rental costs. The general practice of the Government is not to permit escalation of net rent. GSA and the Postal Service, which account for about 87 percent of the total annual rental cost for lease space paid by the Government, do not permit annual escalation of net rent. Escalation or pass-through of annual increases in operating expenses and taxes are permitted by these agencies.

We discussed this matter with the Chief of the Baltimore district's Real Estate Division, and he said he would attempt to revise the escalation provision of the lease.

Apart from escalation of net rent, the lease provides for annual increases in rental attributed to real estate tax increases but it does not provide that the Government will benefit from decreases in real estate taxes. The tax adjustment clause in GSA leases requires that GSA shall receive a prorated share of any decreases in real estate taxes.

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RENT AND MAINTENANCE CHARGES PAID FOR SPACE NOT READY FOR OCCUPANCY

The Corps of Engineers leased the International Tower Building on an "as-is" basis and was therefore required to pay rent and maintenance charges of about $646,000 while it was vacant during layout preparation and alteration. The building was entirely unoccupied for more than 10 months and mostly unoccupied for about 5 additional months until October 1, 1981.

The lease is for a 10-year period, starting July 1, 1980, with automatic renewal annually until June 30, 1990. The annual rent, excluding maintenance, janitorial services, and utilities, is $498,250. Supplemental Agreement No. 1 provided for maintenance services (such as exterior and interior maintenance and maintenance of operating equipment) at an additional cost of $89,908.63 per year, effective October 1, 1980, which was later increased to $96,087, effective July 1, 1981.

This seven-story building was completely unoccupied until May 8, 1981, when NSA occupied the first floor. The second floor became occupied on May 12, 1981, and the remaining five floors became occupied between October 2, and 10, 1981.

As shown below, we estimate that the Government paid rent and maintenance charges of $646,000 for unoccupied space.

		Amount
Rental:		
Entire building unoccupied from July 1, 1980, to May 7, 1981	$423,512	
Prorated based on phased occupancy for six floors from May 8, 1981, to October 1, 1981	142,950	$566,462
Maintenance:		
Entire building unoccupied from October 1, 1980, to May 7, 1981	53,945	
Prorated based on phased occupancy for six floors from May 8, 1981, to October 1, 1981	25,898	79,843
Total rental and maintenance		$646,305

The contract for building alterations was competitively procured by NSA, the tenant agency. NSA officials said they thought that leasing the building as is and contracting competitively for alterations would be the most economical way of obtaining the space. However, they did not anticipate the delay in procuring and completing alterations. The officials said that the delay in completing the alterations was due to a delay in finalizing the design because of a

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last minute switch as to the NSA activities to be housed in the building, the need to obtain legal determinations pertaining to the competitive procurement of alterations, the time required to solicit competitive bids for alteration work, and a delay in getting secure telecommunications equipment installed.

Corps regulations and procedures do not provide guidance on circumstances permitting the leasing of space as is and paying rent for space which is unusable because alterations are needed or the administrative procedures to be applied in such cases.

We have reported similar findings regarding GSA and the Postal Service paying rent for unoccupied space. In March 1980 GSA issued instructions to its regional offices emphasizing that GSA's policy is to lease space fully meeting client agencies' needs with rental payments to begin when the altered space is delivered ready for occupancy. Exceptions to this policy must be justified in writing and approved by a GSA regional administrator. Furthermore, the instructions require that subsequent administration of such as-is leases should ensure that alterations are completed on schedule.

FAILURE TO DETERMINE COMPLIANCE WITH ECONOMY ACT LIMITATION

The Corps' contracting officer did not make the required determination of the Economy Act rental limit for three major leases at the time of lease award. Consequently, he was not in a position to know whether the rent was within the statutory limitation when he signed the leases. Furthermore, for two of these leases, he was not in a position to make the determination because the appraisals of the leased premises did not provide a valid basis for making the determination.

Section 322 of the Economy Act of 1932, as amended (40 U.S.C. 278a), generally limits the net annual rental rate that the Government may pay to not more than 15 percent of the appraised fair market value of the rented premises at the date of the lease. The Economy Act rental limitation is not currently applicable to recruiting station leases and certain other leases. For example, if the appraised fair market value of the premises at the date of the lease is $1 million, the net annual rent is limited to $150,000 during the term of the lease.

The contracting officer is responsible for determining that the proposed net annual rent does not exceed the Economy Act limitation. We found that the required determination was not made for leased space in the International Tower Building and the Airport Square Building at Baltimore-Washington Airport, Maryland, and the College Park Building, College Park, Maryland.

The appraisals made by the Corps prior to lease award for the Airport Square Building and the College Park Building indicated that the net rent for these buildings was in excess of the Economy Act

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limitation. According to Baltimore district real estate officials, these appraisals were not valid for determining compliance with the Economy Act because they did not consider the value of special purpose improvements to be made to the leased premises. In the absence of a revised appraisal or a reappraisal, the Corps was unable to determine whether the net annual rent for space in the Airport Square Building and the College Park Building was within the Economy Act limitation at the time of the lease award.

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